

# **Report of the auditor-general to the Limpopo provincial legislature and the council on Makhado Local Municipality**

## **Report on the financial statements**

### **Introduction**

1. I have audited the financial statements of the Makhado Local Municipality set out on pages 6 to 72, which comprise the statement of financial position as at 30 June 2015, the statement of financial performance, statement of changes in net assets, cash flow statement and the statement of comparison of budget and actual amounts for the year then ended, as well as the notes, comprising a summary of significant accounting policies and other explanatory information.

### **Accounting officer's responsibility for the financial statements**

2. The accounting officer is responsible for the preparation and fair presentation of these financial statements in accordance with South African Standards of Generally Recognised Accounting Practice (SA standards of GRAP) and the requirements of the Municipal Finance Management Act of South Africa, 2003 (Act No. 56 of 2003) (MFMA) and the Division of Revenue Act of South Africa, 2014 (Act No. 10 of 2014) (DoRA), and for such internal control as the accounting officer determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

### **Auditor-general's responsibility**

3. My responsibility is to express an opinion on these financial statements based on my audit. I conducted my audit in accordance with International Standards on Auditing. Those standards require that I comply with ethical requirements, and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.
4. An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgement, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the municipality's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the municipality's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.
5. I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my qualified audit opinion.

## Basis for qualified opinion

### Property, plant and equipment

6. The municipality did not adequately assess at reporting date whether there is any indication that an asset may be impaired, in accordance with SA standards of GRAP 21, *Impairment of non-cash generating assets* and SA standards of GRAP 26, *Impairment of cash generating assets*. The municipality assessed items of property, plant and equipment on a sample basis. As a result impairment was not considered for items of property, plant and equipment with a gross carrying amount of R1 776 162 316. I was not able to determine the impact on the carrying amount of property plant and equipment and surplus for the period, as it was impracticable to do so.

### Sundry debtors

7. I was unable to obtain sufficient appropriate audit evidence that management has assessed whether there is any objective evidence of impairment at the reporting date, as required by SA Standards of GRAP 104, *Financial Instruments*. I was unable to confirm by alternative means whether objective evidence of impairment exists. Consequently, I was unable to determine whether any adjustment to sundry debtors stated at R60 500 815 in the financial statements was necessary. Additionally, there is a consequential impact on the surplus for the period.

### Consumer debtors

8. The municipality applied incorrect financial information in calculating the amount of impairment. Consequently, consumer debtors was overstated by R39 198 696, and the surplus for the year understated by the same amount.

### Property rates

9. The municipality did not affect the adjustments made to the valuation from the effective date of the general valuation roll, as required by the Municipal Property Rates Act, 2004 (Act No. 6 of 2004). Property rates for the current year were based on the general valuation roll. Consequently, property rates was overstated by R12 083 971 in note 24 to the financial statements and gross consumer debtors relating to property rates was overstated by the same amount in note 6 to the financial statements. Additionally, there was a resultant impact on the surplus for the period.

### Unauthorised expenditure

10. I was unable to obtain sufficient appropriate audit evidence that unauthorised expenditure for the current year had been properly disclosed, due to the status of the accounting records. I was unable to confirm the unauthorised expenditure by alternative means. Consequently, I was unable to determine whether any unauthorised expenditure had to be disclosed in note 47 to the financial statements.

### Aggregation of immaterial uncorrected misstatements

11. The financial statements were materially misstated due to the cumulative effect of numerous individually immaterial uncorrected misstatements in the following items included in the statement of financial position and the statement of financial performance.

- Inventories reflected as R113 957 871 was overstated by R9 509 865.
  - Property plant and equipment reflected as R1 776 162 316 was understated by R9 190 214.
  - Accumulated surplus reflected as R1 775 639 186 was overstated by R443 759.
  - Consumer debtors – exchange transactions reflected as R38 154 597 was understated by R150 891.
  - Payables from exchange transactions reflected as R137 656 320 was understated by R124 109.
  - Cash and cash equivalents reflected as R47 449 950 was understated by R88 147.
  - General expenses reflected as R130 973 693 was overstated by R62 744.
12. In addition, I was unable to obtain sufficient appropriate audit evidence and to confirm the following items by alternative means:
- Cash and cash equivalents of R523 217 as included in the disclosed balance of R47 449 950.
  - Sundry debtors of R7 294 959 as included in the disclosed balance of R60 500 815.
  - Other income of R207 519 as included in the disclosed balance of R7 736 628.
  - Accumulated surplus of R1 161 851 as included in the disclosed balance of R1 775 639 186.
  - Gross receivables from non- exchange transactions of R6 891 556 and impairment of R4 341 680 as included in the disclosed balance of R2 549 876.
  - Not included in the disclosed balance of R1 566 329 for heritage assets is an asset I identified of which it was impractical to determine an amount.
- Consequently, I was unable to determine whether any adjustments to these items were necessary.

## **Qualified opinion**

13. In my opinion, except for the effects of the matters described in the basis for qualified opinion paragraphs, the financial statements present fairly, in all material respects, the financial position of the Makhado Local Municipality as at 30 June 2015 and its financial performance and cash flows for the year then ended, in accordance with SA standards of GRAP and the requirements of the MFMA and DoRA.

## **Emphasis of matters**

14. I draw attention to the matters below. My opinion is not modified in respect of these matters.

## **Restatement of corresponding figures**

15. As disclosed in note 41 to the financial statements, the corresponding figures for 30 June 2014 have been restated as a result of errors discovered during 2015 in the financial statements of the municipality at, and for the year ended, 30 June 2014.



## Material electricity losses

16. As disclosed in note 33 to the financial statements, the electricity loss for the municipality is 17.7%, compared to the maximum acceptable loss of 10%.

## Irregular expenditure

17. As disclosed in note 44 to the financial statements, irregular expenditure amounting to R78 766 187 has been incurred by the municipality, due to contravention of the supply chain management (SCM) policy.

## Additional matter

18. I draw attention to the matter below. My opinion is not modified in respect of this matter.

## Unaudited disclosure notes

19. In terms of section 125(2)(e) of the MFMA the municipality is required to disclose particulars of non-compliance with the MFMA. This disclosure requirement did not form part of the audit of the financial statements and accordingly I do not express an opinion thereon.

## Report on other legal and regulatory requirements

20. In accordance with the Public Audit Act of South Africa, 2004 (Act No. 25 of 2004) (PAA) and the general notice issued in terms thereof, I have a responsibility to report findings on the reported performance information against predetermined objectives for selected development priorities presented in the annual performance report, compliance with legislation and internal control. The objective of my tests was to identify reportable findings as described under each subheading, but not to gather evidence to express assurance on these matters. Accordingly, I do not express an opinion or conclusion on these matters.

## Predetermined objectives

21. I performed procedures to obtain evidence about the usefulness and reliability of the reported performance information for the following selected development priorities presented in the annual performance report of the municipality for the year ended 30 June 2015:
- Basic service delivery and infrastructure development: Road transport on pages 27 to 30.
  - Basic service delivery and infrastructure development: Electricity on pages 18 to 26.
  - Basic service delivery and infrastructure development: Waste management on pages 15 to 17.
  - Municipal transformation and organisation development: Corporate services on pages 7 to 8.

22. I evaluated the reported performance information against the overall criteria of usefulness and reliability.
23. I evaluated the usefulness of the reported performance information to determine whether it was presented in accordance with the National Treasury's annual reporting principles and whether the reported performance was consistent with the planned development priorities. I further performed tests to determine whether indicators and targets were well defined, verifiable, specific, measurable, time bound and relevant, as required by the National Treasury's *Framework for managing programme performance information* (FMPPI).
24. I assessed the reliability of the reported performance information to determine whether it was valid, accurate and complete.
25. I did not identify material findings on the usefulness and reliability of the reported performance information for the following selected development priorities:
- Basic service delivery and infrastructure development: Road transport
  - Basic service delivery and infrastructure development: Electricity
  - Basic service delivery and infrastructure development: Waste management
  - Municipal transformation and organisation development: Corporate services

## **Additional matters**

26. Although I identified no material findings on the usefulness and reliability of the reported performance information for the selected development priorities, I draw attention to the following matters.

## **Achievement of planned targets**

27. Refer to the annual performance report on pages 5 to 45 for information on the achievement of planned targets for the year.

## **Adjustment of material misstatements**

28. I identified material misstatements in the annual performance report submitted for auditing on the reported performance information for all the development priorities. As management subsequently corrected the misstatements, I did not identify material findings on the usefulness and reliability of the reported performance information.

## **Unaudited supplementary information**

29. The supplementary information set out on pages 46 to 58 does not form part of the annual performance report and is presented as additional information. I have not audited these schedules and, accordingly, I do not report thereon.

## **Compliance with legislation**

30. I performed procedures to obtain evidence that the municipality had complied with applicable legislation regarding financial matters, financial management and other related matters. My material findings on compliance with specific matters in key legislation, as set out in the general notice issued in terms of the PAA, are as follows

### Strategic planning and performance management

31. The performance management system and related controls were not maintained as it did not represent the processes of performance planning, monitoring, review, reporting and how it is conducted, organised and managed, as required by sections 38 of the Municipal Systems Act, 2000 (Act No. 32 of 2000) (MSA) and regulation 7 of the *Municipal planning and performance management regulations*.
32. The key performance indicators set by the municipality did not include indicators on percentage of households with access to basic level of electricity and solid waste removal, as required by section 43(2) of the MSA and the *Municipal planning and performance management regulation* 10(a).

### Financial statements, performance and annual reports

33. The financial statements submitted for auditing were not prepared in all material respects in accordance with the requirements of section 122 of the MFMA. Material misstatements of non-current assets, current assets, reserves, expenditure and disclosure items identified by the auditors in the submitted financial statements were subsequently corrected, but the uncorrected material misstatements resulted in the financial statements receiving a qualified audit opinion.
34. The annual performance report for the year under review did not include a comparison of the performance with set targets and comparison with the previous financial year, as required by section 46(1)(b) of the MSA.

### Audit committee

35. The audit committee did not advise the council and accounting officer on matters relating to the adequacy, reliability and accuracy of financial reporting and information, as required by section 166(2)(a)(iv) of the MFMA.

### Procurement and contract management

36. Bids were not always evaluated by bid evaluation committees which were composed of at least one SCM practitioner of the municipality as required by *Supply Chain Management Regulation* (SCM Regulation) 28(2).
37. Contracts were awarded to bidders based on points given for criteria that differed from those stipulated in the original invitation for bidding, in contravention of SCM Regulations 21(b) and 28(1)(a) and the *Preferential Procurement Regulations*.
38. Bid adjudication was not always done by committees which were composed in accordance with SCM Regulation 29(2).

39. Contracts were awarded to bidders based on preference points that were not allocated and calculated in accordance with the requirements of the Preferential Procurement Policy Framework Act, 2000 (Act No. 5 of 2000) (PPPFA) and its regulations.
40. Contracts were awarded to bidders that did not score the highest points in the evaluation process, as required by section 2(1)(f) of PPPFA.
41. A SCM role player whose partner had a private or business interest in contracts awarded by the municipality participated in the process relating to that contract, in contravention of SCM Regulation 46(2)(f).

### Irregular and fruitless and wasteful expenditure

42. Reasonable steps were not taken to prevent irregular expenditure and fruitless and wasteful expenditure, as required by section 62(1)(d) of the MFMA.

### Revenue management

43. An effective system of internal control for revenue was not in place, as required by section 64(2)(f) of the MFMA.

### **Internal control**

44. I considered internal control relevant to my audit of the financial statements, annual performance report and compliance with legislation. The matters reported below are limited to the significant internal control deficiencies that resulted in the basis for qualified opinion and the findings on compliance with legislation included in this report. .

### **Leadership**

45. The accounting officer and management did not exercise oversight responsibility over the enforcement of the SCM policy.
46. Management did not have sufficient monitoring controls to ensure the reliability of reported performance information and the fairly presentation of the financial statements.
47. Management did not in all instances address the recommendations of the internal audit unit and audit committee.

### **Financial and performance management**

48. The financial statements contained numerous misstatements that were corrected and those not corrected resulted in a qualified audit opinion. This was mainly due to officials in the finance unit not fully understanding the requirements of the financial reporting framework.
49. Supply chain management processes were not monitored due to lack of understanding and implementation of SCM regulations, resulting in irregular expenditure.

### **Governance**

50. The activities performed by the internal audit unit did not prevent the municipality from regressing to a qualified audit opinion and assist the municipality to improve its internal control environment that supports financial and performance reporting and compliance with legislation.

## Other reports

### Investigation

51. The municipality requested an independent service provider to conduct an investigation into possible fraudulent payments. Emanating from the investigation, two employees were dismissed and the internal disciplinary hearing process against one employee is currently in progress. Criminal proceedings have been instituted against an employee and a service provider.

*Auditor-General.*

Polokwane

30 November 2015



AUDITOR - GENERAL  
SOUTH AFRICA

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